SUPREME COURT OF THE UNITED STATES.

No. 162.—October Term, 1927.

Samuel J. Kornhauser, Petitioner,
vs.
The United States.
} On Writ of Certiorari to the Court of Claims.

[February 20, 1928.]

Mr. Justice Sutherland delivered the opinion of the Court.

The petitioner sued in the Court of Claims to recover $1,126.15, the amount by which his income tax for the year 1918 was increased by reason of the refusal of the Commissioner of Internal Revenue to allow a deduction from petitioner's gross income of the sum of $10,000 claimed as a business expense for that year. The petition alleges that the latter sum was paid by petitioner for attorney's fees incurred in the defense of a suit against him for an accounting instituted by his former co-partner, said suit growing directly out of the conduct of the partnership business, it being alleged by the co-partner that petitioner had collected fees or compensation for professional services performed during the existence of the partnership to a division of which the co-partner was entitled; that the alleged fees in fact consisted of stock in a corporation acquired subsequently to the dissolution of the partnership and not for services performed during its existence; that the defense to the suit was successful and the amount paid was a necessary expense incurred in connection with petitioner's business within the meaning of § 214(a), subd. (1), of the Revenue Act of 1918, or a loss within the meaning of subd. (4) of the same section; that a claim for refund of the excessive tax was duly made to the Commissioner and by him rejected. To this petition a demurrer was interposed and by the court below sustained and the petition dismissed on the ground that the expenditure was not an allowable deduction under either provision of the statute, but was a personal expense under § 215(a) of the Revenue Act of 1918. 62 C. Cls. 647.

We think it is obvious that the expenditure is not a loss; and the only provisions of the Revenue Act (c. 18, 40 Stat. 1057, 1066, 1069) which need be considered are § 214(a), subd. (1), which reads:

"Sec. 214. (a) That in computing net income there shall be allowed as deductions:

"(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, . . ."

and § 215(a) which provides:

"Sec. 215. That in computing net income no deduction shall in any case be allowed in respect of—

"(a) Personal, living, or family expenses."

On the case made by the petition the expenditure in question was either a personal expense or a business expense:—it was not a living or family expense. And it was an "ordinary and necessary" expense, since a suit ordinarily and, as a general thing at least, necessarily requires the employment of counsel and payment of his charges. The petition is not as definite as it might have been, but from its allegations, interpreted as the Solicitor General concedes they may be, it appears that the accounting suit presented the question whether the compensation in respect of which the co-partner sought an accounting was for professional services performed by petitioner during the existence of the partnership or after its termination, the defense to that suit being based upon the latter alternative. In either view, the compensation constituted business earnings.

The Solicitor of Internal Revenue in a recent opinion has held that legal expenses incurred by a doctor of medicine in defending a suit for malpractice were business expenses within the meaning of the statute. In the course of the opinion it was said that such expenditures were as much ordinary and necessary business expenses as they would be if made by a merchant in defending an action for personal injuries caused by one of his delivery automobiles, and that in the latter case the deduction would be allowed without question. C. B. V. 1, p. 226.

Another departmental ruling is to the effect that legal expenses incurred in defending an action for damages by a tenant injured while at work on the taxpayer's farm are deductible as a business expense. C. B. 5, p. 121.

In the *Appeal of F. Meyer & Brother Co.*, 4 B. T. A. 481, the Board of Tax Appeals held that a legal expenditure made in defending a suit for an accounting and damages resulting from an alleged patent infringement was deductible as a business expense.

The basis of these holdings seems to be that where a suit or action against a taxpayer is directly connected with, or, as otherwise stated (*Appeal of Backer*, 1 B. T. A. 214, 216), proximately resulted from, his business, the expense incurred is a business expense within the meaning of § 214(a), subd. (1), of the act. These rulings seem to us to be sound and the principle upon which they rest covers the present case. If the expense had been incurred in an action to recover a fee from a client who refused to pay it, the character of the expenditure as a business expense would not be doubted. In the application of the act we are unable to perceive any real distinction between an expenditure for attorney's fees made to secure payment of the earnings of the business and a like expenditure to retain such earnings after their receipt. One is as directly connected with the business as the other.

Judgment reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

END

OF

CASE